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Securities Regulation Incident To Certificates Of Deposit And Privately Negotiated Agreements: Departures From A Functionally Operative Security Definition

Marine Bank v. Weaver, 102 S. Ct. 1220 (1982).

I. INTRODUCTION

Almost half a century has passed since Congress promulgated the Securities Act of 1933¹ and the Securities Exchange Act of 1934,² which were designed to curb abuses within those financial environments utilizing a "security."³ During that time, the ostensi-

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1. 15 U.S.C. §§ 77a-77bbbb (1976 & Supp. V 1981) [hereinafter referred to as the Securities Act of 1933 or the 1933 Act].
 2. 15 U.S.C. §§ 78a-78kk (1976 & Supp. V 1981) [hereinafter referred to as the Exchange Act of 1934 or the 1934 Act].
 3. The Securities Act of 1933 defines the term "security" as follows:

When used in this subchapter, unless the context otherwise requires—

(1) The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, pre-organization certificate or subscription, transferable share, investment contract, voting trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase any of the foregoing.

- 15 U.S.C. § 77(b)(1) (1976). "Security" is defined in the 1934 Act as follows:

When used in this chapter unless the context otherwise requires. . .

(10) The term "security" means any note, stock treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or

ble anti-fraud workhorse of the the two acts has been section 10(b) of the 1934 Act⁴ and rule 10b-5.⁵ Application of these provisions provides a federal forum⁶ as well as a private cause of action,⁷ which in turn has provided a fertile opportunity for prospective plaintiffs to attempt an application of the securities laws to their

subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance, which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

15 U.S.C. § 78c(a) (10) (1976). *See also infra* note 79.

4. Section 10(b) of the 1934 Act provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

....
(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b) (1976). *See generally* L. LOSS, *SECURITIES REGULATION* 1421-1519 (2d ed. 1961 & Supp. 1969) [hereinafter cited as LOSS].

5. SEC rule 10b-5 provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made in the light of circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (1982). It has been noted that the securities laws were created to provide protection "wherever there are savings accounts, wherever people invest their funds . . . [wherever people have] suffered because of lack of information concerning investments that have been recommended to them." 77 CONG. REC. 2914 (1933).

6. The 1934 Act § 27, 15 U.S.C. § 78aa (1976), confers upon the federal courts exclusive jurisdiction over suits arising from the Act.

7. The Supreme Court has clearly established the right of individual enforcement under section 10(b) and rule 10b-5. *Herman & MacLean v. Huddleston*, 51 U.S.L.W. 4099 (U.S. 1983); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 196 (1976); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 729-30 (1975); *Superintendent of Ins. v. Bankers Life and Cas. Co.*, 404 U.S. 6, 13 n.9 (1971). *See LOSS, supra*, note 4, at 3869-73; *Wermeil, Justices Upheld Investor's Right To Sue For Fraud*, *Wall St. J.*, Jan. 25, 1983, at 4, col. 1.

specific dilemma.⁸ One of the most frequently alleged bases for federal subject matter jurisdiction under the securities laws is the presence of a "note" transaction.⁹

In *Marine Bank v. Weaver*,¹⁰ the United States Supreme Court confronted the issue of whether a certificate of deposit¹¹ issued by a federally regulated bank was to be deemed a "security" for purposes of the federal securities law and anti-fraud provisions.¹² The

8. "The relative ease with which one may recover for a violation of SEC Rule 10b-5 has led prospective plaintiffs to seek redress in federal forums even though their claims do not involve instruments which fall within the everyday conception of securities." Comment, *Commercial Notes and Definition of "Security" Under Securities Exchange Act of 1934: A Note is a Note is a Note*, 52 NEB. L. REV., 478, 478-79 (1973). Such applications have involved, for example, noncontributory pension plan participations, the stock of a cooperative housing association, franchise agreements, land sales contracts, and whiskey warehouse receipts. See generally Sonnenschein, *Federal Securities Law Coverage of Note Transactions: The Antifraud Provisions*, 35 BUS. LAW. 1567, 1567 n.1 (1980).

9. In the last several years a number of commentators have discussed this topic. See FitzGibbon, *What is a Security?—A Redefinition Based on Eligibility to Participate in the Financial Markets*, 64 MINN. L. REV. 893 (1980); Hannan & Thomas, *The Importance of Economic Reality and Risk in Defining Federal Securities*, 25 HASTINGS L.J. 219 (1973-74); Lipton & Katz, "Notes" Are Not Always Securities, 30 BUS. LAW. 763 (1975); Lipton & Katz, "Notes" Are (Are Not?) Always Securities—A Review, 29 BUS. LAW. 861 (1974); Schneider, *The Elusive Definition of a Security*, 14 REV. SEC. REG. 981 (1981); Sonnenschein, *supra* note 8; Comment, *Notes as Securities Under the Securities Act of 1933 and the Securities and Exchange Act of 1934*, 36 MD. L. REV. 223 (1976); Comment, *supra* note 8; Note, *Bank Certificates of Deposit: Notes Not in Tune with Securities Regulation*, 10 FORDHAM URB. L.J. 469 (1982). See also Annot., 39 A.L.R. FED. 357 (1978 & Supp. 1982). For initial commentaries analyzing the *Weaver* decision, see Arnold, *Marine Bank v. Weaver: New Guidance On What Is Not a Security*, 53 OKLA. B.J. 2199 (1982); Pitt, "Weaver" Could Invite New Generation of Litigation, Wash. Legal Times, Mar. 15, 1982, at 11, col. 1.

10. 102 S. Ct. 1220 (1982).

11. The federal regulations provide:

The term "time certificate of deposit" means a deposit evidenced by a negotiable or nonnegotiable instrument which provides on its face that the amount of such deposit is payable to bearer or to any specified person or to his order:

(1) On a certain date, specified in the instrument, not less than 30 days after the date of deposit, or

(2) At the expiration of a certain specified time not less than 30 days after the date of the instrument, or

(3) Upon notice in writing which is actually required to be given not less than 30 days before the repayment, or

(4) In all cases only upon presentation and surrender of the instrument.

12 C.F.R. § 217.1(c) (1982).

12. An important aspect of the decision dealt with the question of whether a personal profit sharing agreement fell within the definition of a security. For an analysis of this agreement by the Court, see *infra* notes 109-23 and accompanying text.

Weaver decision provided a conditional answer to an issue which has been the subject of judicial dialogue for some time,¹³ holding that the certificate of deposit in the present case was *not* a security.¹⁴ More importantly, however, *Weaver* develops and redefines the Court's previous fundamental analysis as to what is, and what is not, a security.

The purpose of this Note is to demonstrate (1) the impact of the Court's decision on prior judicial interpretations as to what constitutes a security; (2) refinements to the Court's own basic test; and (3) the creation of new ambiguities concerning the proper reach of the federal securities laws.

II. THE *WEAVER* FACTS

In February of 1978, Sam and Alice Weaver purchased a \$50,000 six-year certificate of deposit from Marine Bank.¹⁵ The note¹⁶ had a six-year maturity, bore interest at the rate of 7.5 percent, and was insured for up to \$40,000 by the Federal Deposit Insurance Corporation (FDIC).¹⁷ The Weavers then pledged the certificate back to Marine Bank to guarantee a \$65,000 loan by the bank to a wholesale slaughterhouse and retail meat market company, Columbus Packing Company, owned by Raymond and Barbara Piccirillo.¹⁸ In consideration for the loan guarantee, the Weavers entered into a separate agreement with the Piccirillos whereby the Weavers were to receive fifty percent of the net profits of the Piccirillos' business

13. See, e.g., *Canadian Imperial Bank of Commerce Trust Co. v. Fingland*, 615 F.2d 465 (7th Cir. 1980); *Burrus, Cootes and Burrus v. MacKethan*, 537 F.2d 1262 (4th Cir. 1976), *opinion withdrawn and prior judgment aff'd on other grounds*, 545 F.2d 1388 (4th Cir. 1976), *cert. denied*, 434 U.S. 826 (1977); *Bellah v. First National Bank of Hereford*, 495 F.2d 1109 (5th Cir. 1974); *Superintendent of Ins. v. Bankers Life and Cas. Co.*, 300 F. Supp. 1083 (S.D.N.Y. 1969), *aff'd on other grounds*, 430 F.2d 355 (2d Cir. 1970), *rev'd on other grounds*, 404 U.S. 6 (1972).

14. 102 S. Ct. at 1223.

15. *Id.* at 1222.

16. A certificate of deposit is "a note of the issuing bank which recites that an amount of money has been deposited and will be paid by the bank to a named person or bearer." F. BEUTEL, *BANK OFFICER'S HANDBOOK OF COMMERCIAL BANKING LAWS* 85 (4th ed. 1974) (emphasis added), *quoted in* Note, *supra* note 9, at 475. *But see* U.C.C. § 3-104(2)(d) (1978) (the explicit definition of "note" in the Uniform Commercial Code recognizes an instrument which complies with certain requirements as "a 'note' if it is a promise *other than* a certificate of deposit"). *Id.* (emphasis added).

17. 102 S. Ct. at 1222 & n.1. While the certificate of deposit could only be insured up to \$40,000 by the FDIC at the time the Weavers purchased it, the ceiling on insured deposits has since been raised to \$100,000. 12 U.S.C. § 1813(m)(1) (1976), *as amended by* Act of March 31, 1980, Pub. L. No. 96-221, § 308(b)(1), 94 Stat. 147 (1980).

18. 102 S. Ct. at 1222.

and one hundred dollars per month for the duration of the guarantee.¹⁹ In addition, the Weavers were given the right, at the discretion of the Piccirillos, to use a barn and pasture owned by the company as well as the right to veto future borrowing of the business.²⁰

Subsequent to the transactions, the Weavers discovered that the slaughterhouse owed the bank approximately \$33,000 for prior loans,²¹ which the Weavers contended was not disclosed to them at the time the agreements were negotiated.²² The business eventually went bankrupt, and the bank indicated its intent to claim the pledged certificate of deposit as security.²³

Faced with the possibility of losing the assets they had pledged to Marine Bank, the Weavers initiated suit against the bank, alleging, *inter alia*, a violation of section 10(b) of the Securities Exchange Act of 1934.²⁴ The Weavers alleged that the bank officers had told them that the proceeds of the loan they were guaranteeing would be used by the slaughterhouse as working capital. Instead, nearly all of the money was applied to repay prior bank loans and cover an overdrawn checking account.²⁵ In essence, the Weavers' complaint contained allegations that they had been defrauded in connection with the sale of the certificate of deposit and the separate profit sharing agreement between the Piccirillos and themselves.²⁶

The district court entered summary judgment for the bank on

19. *Id.*

20. *Id.*

21. The Weavers contended that Marine Bank was unable to collect the \$33,000 of outstanding loan payments from Columbus, and thus became actively involved in persuading the Piccirillos to secure an investor for Columbus. The Weavers further contended the bank had represented to them that, *inter alia*, there was little risk to the Weavers in making the pledge, the collateral was substantial enough to protect the bank and the Weavers, and that the bank would provide the Weavers a monthly report so they could monitor the activities of Columbus. Brief for Respondents at 4, 7.

22. 102 S. Ct. at 1222. The certificate owners asserted that had they known of the slaughterhouse's precarious financial condition, they would not have guaranteed the loan by pledging their certificate of deposit. *Id.*

23. *Id.* While the certificate had not yet been claimed by the bank at the time the litigation commenced, the bank conceded that its other security was inadequate, and that it would consequently claim the pledged note.

24. *Id.* See *supra* note 4. The Weavers also pleaded pendent claims for violations of the Pennsylvania Securities Act and for common law fraud by the bank.

25. *Id.* The Court noted that the bank kept approximately \$42,800 to satisfy its prior loans and Columbus' overdrawn checking account. All but \$3,800 of the remainder was disbursed to pay overdue taxes and to satisfy other creditors.

26. *Id.* Although Marine Bank did not specifically deny that it had solicited the Weavers to pledge the certificate of deposit as collateral for the Piccirillo loan, it did deny that it had any knowledge of the purchase agreement made between the Weavers and the Piccirillos. Brief for Petitioner at 4.

the section 10(b) claim on the basis that "if a wrong occurred, it did not take place 'in connection with a purchase or sale of any security,' as required for liability under §10(b)." ²⁷ The Court of Appeals for the Third Circuit reversed, holding that a finder of fact could reasonably conclude that either the certificate of deposit or the agreement between the Weavers and the Piccirillos was a security.²⁸ The Supreme Court held that neither the certificate of deposit nor the profit sharing agreement fell within the protections for which the securities laws were enacted, and, accordingly, reversed and remanded the case to the court of appeals.²⁹

III. ANALYSIS

A. Judicial Definition and Treatment of Securities

1. *The Supreme Court*

The definitions of "security" in the 1933 and 1934 Acts³⁰ were drafted "in sufficiently broad and general terms so as to include within the definition of the many types of instruments that in our commercial world fall within the ordinary concept of a security."³¹ The obvious breadth and flexibility of these provisions, coupled with the absence of any interpretations of the definitional language by the draftsmen, have relegated to the judicial branch an opportunity to develop a set of practicable guidelines. In fact, in the last forty years, the Supreme Court has decided on eight occasions whether a specific instrument was a security for purposes of the federal securities laws.³²

27. 102 S. Ct. at 1222.

28. *Id.* at 1222-23 (citing *Weaver v. Marine Bank*, 637 F.2d 157 (3d Cir. 1980)).

29. *Id.* at 1223. The remand to the Court of Appeals was to determine whether the pendent state claims should be entertained.

30. *See supra* note 3.

31. H.R. REP. NO. 85, 73d Cong., 1st Sess. 11 (1933). The acts were passed in order "to protect the investing public and honest business. The basic policy is that of informing the investor of the facts concerning securities to be offered for sale in interstate and foreign commerce and providing protection against fraud and misrepresentation." S. REP. NO. 47, 73d Cong., 1st Sess. 1 (1933). President Roosevelt, in his 1933 message to Congress proposing securities legislation, stated: "The proposal adds to the ancient rule of caveat emptor, the further doctrine 'let the seller also beware.'" H.R. Doc. No. 12, 73d Cong., 1st Sess. 1 (1933). For an exhaustive study of the legislative history of the securities acts, including the bills and enactments, see *LEGISLATIVE HISTORY OF THE SECURITIES ACT OF 1933 AND SECURITIES EXCHANGE ACT OF 1934* (J. Ellenberger & E. Mahar eds. 1973).

32. *See Weaver*, 102 S. Ct. 1220; *International Bhd. of Teamsters v. Daniel*, 439 U.S. 551 (1979); *United Housing Found. v. Forman*, 421 U.S. 837, 858 (1975); *Superintendent of Ins. v. Bankers Life and Cas. Co.*, 404 U.S. 6 (1971); *Tcherepnin v.*

Ten years after the promulgation of the 1933 Act, the Supreme Court, in *SEC v. C.M. Joiner Leasing Corp.*,³³ issued its first opinion on the interpretation of this definitional language. The Court conferred a broad interpretation upon the statutory language in order to cover all aspects of fraud for which the act was intended:

[T]he reach of the Act does not stop with the obvious and commonplace. Novel, uncommon, or irregular devices, whatever they appear to be, are also reached if it be proved as a matter of fact that they were widely offered or dealt in under terms or courses of dealing which established their character in commerce as 'investment contracts,' or as 'any interest or instrument commonly known as a "security."'³⁴

Three years later, the Supreme Court attempted to develop functional guidelines for defining a security in *SEC v. W.J. Howey Co.*,³⁵ where the Court determined that sales contracts for plots of orchard land and contracts to service the fruit trees constituted an investment contract for purposes of the 1934 Exchange Act.³⁶ In *Howey*, the defendant corporation publicly offered small parcels of a citrus grove coupled with an optional contract for harvesting and marketing the produce. All the produce was then pooled for sale, and the promoters dispersed each purchaser's share of the net proceeds in accordance with the output from each parcel.³⁷ Justice Murphy, writing for the majority, created a test from those elements which he concluded were pertinent in determining the existence of an investment contract: "[A]n investment contract for purposes of this Securities Act means a contract, transaction or scheme whereby [1] a person invests his money [2] in a common enterprise and is led to expect profits [3] solely from the efforts of the promoter or a third party . . ."³⁸ The Court's decision quickly became known and "codified" as the three-prong *Howey* standard by numerous lower courts.³⁹ It soon became apparent, however,

Knight, 389 U.S. 332 (1967); *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202 (1967); *SEC v. Variable Annuity Life Ins. Co. of America*, 359 U.S. 65 (1959); *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946); *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344 (1943).

33. 320 U.S. 344 (1943).

34. *Id.* at 351.

35. 328 U.S. 293 (1946).

36. *Id.* at 300. In *Howey*, the Court was not defining the term "security" in general, but only an investment contract. The Court has subsequently stated, however, that it perceives no distinction between an "investment contract" and an "instrument commonly known as a 'security'" and that the *Howey* test "embodies the essential attributes that run through all of the Courts' decisions defining a security." *Foreman*, 421 U.S. at 852.

37. 328 U.S. at 295-96.

38. *Id.* at 299.

39. See *infra* notes 56-72 and accompanying text.

that the *Howey* codification contained "seeds of its own destruction."⁴⁰

Consequently, the Court in later decisions made several efforts at reinterpreting the three-pronged test, the most important of which were *United Housing Foundation v. Foreman*⁴¹ and *International Brotherhood of Teamsters v. Daniel*.⁴² In *Foreman*, the plaintiff-tenants were required to purchase shares of "stock" in a publicly financed, low income housing project in order to lease an apartment from the defendant housing cooperative.⁴³ The Court noted that even though the interests which the tenants purchased were called "stock," the label itself was not enough to bring the interests within the purview of the securities laws simply by virtue of the fact that the statutory definition included the word "stock."⁴⁴ The Court stated that "[b]ecause securities transactions are economic in character Congress intended the application of these statutes to turn on the *economic realities* underlying a transaction, and not on the name appended thereto."⁴⁵

The Court pointed out that from an "economic realities" standpoint, the cooperative purchase arrangement failed the *Howey* test for two essential reasons. First, the Court stated that "there can be no doubt that investors were attracted solely by the prospect of acquiring a place to live, and not by *financial returns* on their investments."⁴⁶ Second, the Court noted that the profits hoped for by the potential investor were not "derived from the *entrepreneurial* or *managerial* efforts of others."⁴⁷ As one commenta-

40. Hannan & Thomas, *supra* note 9, at 225. An example of the type of problem that has arisen from the *Howey* test is the fact that it designates profits coming *solely* from the efforts of others. A literal interpretation of this condition would exclude an interest in any venture where the investor contributed his own efforts. See, e.g., *S.E.C. v. Glenn W. Turner Enterprises*, 474 F.2d 476, 482 (9th Cir. 1973) (holding that the word "solely" does not really mean "solely," and that the word should not be read as a strict or literal limitation on the definition of an investment contract because such a literal application would induce easy evasion by simply adding a requirement that the buyer contribute a modicum of effort). For a discussion of the "common enterprise" requirement, see *infra* notes 114-23 and accompanying text.

41. 421 U.S. 837 (1975).

42. 439 U.S. 551 (1979).

43. 421 U.S. at 842.

44. *Id.* at 848.

45. *Id.* at 849 (emphasis added). The Court reemphasized its earlier opinion that "in searching for the meaning and scope of the word 'security' in the Acts, form should be disregarded for substance and the emphasis should be on economic reality." *Id.* (quoting *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967)).

46. *Id.* at 853 (emphasis added).

47. *Id.* at 852 (emphasis added). In commenting on the *Howey* decision, the majority held that the "touchstone" of the definition of a security:

is the presence of investment in a common venture premised on a reasonable expectation of profits to be derived from the en-

tor has noted, while the Court's opinion in *Foreman* never explicitly departed from *Howey*, it might be viewed as adding two new requirements: first, that the return be "financial" in form; and second, that the activities engaged in by the issuer—the activities which put it in a position to furnish a return on the securities investment—be predominantly "entrepreneurial or managerial."⁴⁸

In *International Brotherhood of Teamsters v. Daniel*,⁴⁹ the second major Supreme Court case interpreting *Howey*, the Court decided that a compulsory, noncontributory pension plan did not constitute a "security" for purposes of the federal securities acts.⁵⁰ The Court held that the "investment of money" requirement mandated by *Howey* was not satisfied because "the purported investment [was] a relatively insignificant part of an employee's total and indivisible package"⁵¹ In addition, the Court found that any expectation of profits was not derived from the efforts of others. Indeed, any anticipated profit depended "primarily on the employee's efforts to meet the vesting requirements, rather than the fund's investment success."⁵²

After marching the pension plan in *Daniel* through the *Howey* test, the Court discussed the application of the Employee Retirement Income Security Act of 1974 (ERISA)⁵³ to the situation in *Daniel*:

The existence of this comprehensive legislation governing the use and terms of employee pension plans severely undercuts all arguments for extending the Securities Acts to noncontributory, compulsory pension plans. Congress believed that it was filling a regulatory void when it enacted ERISA Not only is the extension of the Securities Acts by the court

entrepreneurial or managerial efforts of others. By profits, the Court has meant . . . a participation in earnings resulting from the use of investors' funds. . . . In such cases the investor is "attracted solely by the prospects of a return on his investment."

Id. (citations omitted).

48. FitzGibbon, *supra* note 9, at 903.

49. 439 U.S. 551 (1979).

50. *Daniel* dealt with the issue of whether an interest in the Teamsters' Union Pension Fund was a security. The fund was established out of contributions made by employers of Teamsters; collective bargaining agreements required those employers to make payments to the fund in proportion to the number of Teamsters that they employed. 439 U.S. at 553. The plan did not permit employees to opt out, nor did it in general contemplate their making contributions themselves. Upon retirement, an eligible employee received a pension in a fixed amount determined according to a formula based on anticipated employer contributions, anticipated performance of the investments made, and the anticipated amount of other pensions paid out. *Id.* at 554.

51. 439 U.S. at 560.

52. *Id.* at 562.

53. 29 U.S.C. §§ 1001-1381 (1976 & Supp. V 1981).

below unsupported by the language and history of these acts, but in light of ERISA it serves no general purpose.⁵⁴

It thus appears that even if the three-pronged *Howey* test and the two additional elements enunciated in *Foreman* are satisfied, the Court will still refuse to apply the federal securities laws where other comprehensive governing legislation exists. As has been recognized by at least one commentator, this principle, introduced as something of an afterthought in *Daniel*, was to reappear as a major precept in the *Marine Bank* opinion.⁵⁵

2. The Lower Courts

The circuit courts have developed three basic approaches in determining whether an instrument falls under the statutory definition of security, primarily because the courts have applied modified interpretations and emphases to the *Howey-Foreman-Daniel* rules.⁵⁶ A general examination of the three views reveals an emphasis on different factors in the Supreme Court formulations, and the necessary requirement of flexibility has sometimes led to vague and indefinite conclusions.⁵⁷ Nevertheless, the courts have used one of these three approaches in assessing whether specific instruments are securities.⁵⁸

The analytical theory applied by the largest majority of circuit courts is the commercial-investment dichotomy, followed by the Third, Fifth, Seventh, and Tenth Circuits.⁵⁹ This theory encom-

54. 439 U.S. at 569-70.

55. Arnold, *supra* note 9, at 2201. See *infra* notes 92-103 and accompanying text for a discussion of the preemption of the securities acts by other governing legislation.

56. See, e.g., SEC v. Diversified Indus., Inc., 465 F. Supp. 104, 108-11 (D.D.C. 1979) ("Unfortunately, the U.S. Circuit Courts of Appeals that have confronted this issue have devised somewhat different tests to determine whether a note constitutes a security . . .") *Id.* at 108.

57. See, e.g., Great W. Bank and Trust v. Kotz, 532 F.2d 1252 (9th Cir. 1976) ("We do not hold that application of any single factor discussed above compels us to affirm the judgment of the district court. Nor do we intimate that in a different case there would not be other factors to consider.") *Id.* at 1258.

58. See *infra* notes 59-72 and accompanying text. For an analysis of the three judicial approaches, see Lipman, *Notes As Securities*, 14 REV. SEC. REG. 933 (1981); Sonnenschein, *supra* note 9, at 1589-1605; Note, *supra* note 9, at 478-86.

59. United States v. Namer, 680 F.2d 1088 (5th Cir. 1982); First Nat'l Bank of Las Vegas, New Mexico v. Estate of Russell, 657 F.2d 668 (5th Cir. 1981); Meason v. Bank of Miami, 652 F.2d 542 (5th Cir. 1981), *cert. denied*, 455 U.S. 939 (1982); American Fletcher Mortgage Co. v. United States Steel Credit Corp., 635 F.2d 1247 (7th Cir. 1980); United Am. Bank of Nashville v. Gunter, 620 F.2d 1108 (5th Cir. 1980); National Bank of Commerce v. All Am. Assurance Co., 583 F.2d 1295 (5th Cir. 1978); McGovern Plaza Joint Venture v. First Nat'l Bank of Denver, 562 F.2d 645 (10th Cir. 1977); Emisco Industries v. Pro's Inc., 543 F.2d 38 (7th Cir. 1976); C.N.S. Enters. v. G & G Enters., 508 F.2d 1354 (7th Cir. 1975); Zabriskie v. Lewis, 507 F.2d 546 (10th Cir. 1974); SEC v. Continental Commodities Corp., 497 F.2d 516 (5th Cir. 1974); McClure v. First Nat'l Bank of Lub-

passes a process of analyzing the instrument in the context of the underlying transaction and comparing it to the kinds of transactions which the anti-fraud provisions are intended to cover. It has been explained that under this approach, note transactions are judged against the attributes of an "investment" and only transactions that are deemed "sufficient" to display those attributes are accorded anti-fraud coverage.⁶⁰ In essence, a transaction involving a note must be of an "investment" rather than a "commercial" nature for the note to be a security.⁶¹

The second doctrine has been labeled the "risk capital" approach, followed almost exclusively by the Ninth Circuit.⁶² The crux of this test is, applying *Howey*, based on an analysis of whether an investor has provided "assets to the enterprise in such a manner as to subject himself to financial loss."⁶³ The court essentially asks whether investors have contributed "risk capital" subject to the entrepreneurial or managerial efforts of others.⁶⁴ The

bock, 497 F.2d 490 (5th Cir. 1974); *Bellah v. First Nat'l Bank of Hereford*, 495 F.2d 1109 (5th Cir. 1974); *Lino v. City Investing Co.*, 487 F.2d 689 (3d Cir. 1973); *Sanders v. John Nuveen & Co.*, 463 F.2d 1075 (7th Cir.), *cert. denied*, 409 U.S. 1009 (1972).

60. *Sonnenschien*, *supra* note 9, at 1588.

61. *Meason v. Bank of Miami*, 652 F.2d 542, 548 (5th Cir. 1981), *cert. denied*, 455 U.S. 939 (1982); *Bellah v. First Nat'l Bank of Hereford*, 495 F.2d 1109, 1113 (5th Cir. 1974).

62. *SEC v. Murphy*, 626 F.2d 633 (9th Cir. 1980); *Amfac Mortgage Corp. v. Arizona Mall of Tempe, Inc.*, 583 F.2d 426 (9th Cir. 1978); *United Cal. Bank v. THC Fin. Corp.*, 557 F.2d 1351 (9th Cir. 1977); *Great W. Bank and Trust v. Kotz*, 532 F.2d 1252 (9th Cir. 1976); *El Khadem v. Equity Sec. Corp.*, 494 F.2d 1224 (9th Cir. 1974). Although not adopting the risk capital approach to securities per se, the Sixth Circuit has recently applied the risk capital approach in order to determine if the "presence of an investment" condition exists for purposes of applying the *Howey* test. *Union Planters Nat'l Bank of Memphis v. Commercial Credit Business Loans, Inc.*, 651 F.2d 1174 (6th Cir. 1981). *See also American Bank and Trust Co. v. Wallace*, 702 F.2d 93 (6th Cir. 1983).

63. *Hecter v. Wiens*, 533 F.2d 429, 432 (9th Cir. 1976).

64. *Great W. Bank and Trust v. Kotz*, 532 F.2d 1252, 1257 (9th Cir. 1976) (construing *SEC v. W.J. Howey, Inc.*, 328 U.S. 294 (1946)). *See supra* notes 47-48 and accompanying text for a discussion of the entrepreneurial/managerial element.

The test was first enunciated by Judge Traynor in *Silver Hills Country Club v. Sobieski*, 55 Cal. 2d 811, 361 P.2d 906, 13 Cal. Rptr. 186 (1961). *Sobieski* involved a partnership which sought to finance a country club operation by the sale of "memberships" which they claimed were not investments because the memberships conveyed no rights in the assets or income of the club. The California Commissioner of Corporations claimed the club memberships fell within the literal definition of a "beneficial interest in title to property, profits, or earnings." *Id.* at 813, 361 P.2d at 907, 13 Cal. Rptr. at 187. The court found the promotional memberships to be within the regulatory purposes of the California law, relying on the fact that the capital solicited to finance the venture for profit was put at risk. *Id.* at 815, 361 P.2d at 908, 13 Cal. Rptr. at 188. The court noted that the objective of the "risk capital" approach was "to af-

Ninth Circuit has specifically identified the following six factors as material in measuring the risk involved: (1) time; (2) collateralization; (3) form of the obligation; (4) circumstances of issuance; (5) relationship between the amount borrowed and the size of the borrower's business; and (6) the contemplated use of the funds.⁶⁵

A third approach, adopted by the Second Circuit,⁶⁶ retreats from the scheme of analyzing the context of the transaction or the existence of risk in note transactions. This approach, commonly called the "literal view,"⁶⁷ espouses the theory that an instrument is a security if it simply falls within the plain terms of the acts.⁶⁸ Consequently, the party asserting that a note is not within the anti-fraud provisions of the acts has the burden of showing that "the context otherwise requires."⁶⁹ Judge Friendly, writing for the Second Circuit, proffered guidance for determining whether this burden has been met by enumerating a set of examples:

One can readily think of many cases where [the context does otherwise require]—the note delivered in consumer financing, the note secured by a mortgage on a home, the short-term note secured by a lien on a small business or some of its assets, the note evidencing a "character" loan to a bank customer, short-term notes secured by assignment of accounts receivable, or a note which simply formalizes an open-account debt incurred in the ordinary course of business (particularly if, as in the case of the customer of a broker, it is collateralized). When a note does not bear a strong family resemblance to these examples and has a maturity exceeding nine months, Section 10(b) of the 1934 act should be held to apply. We realize this approach does not afford complete certainty but it adheres more closely to the language of the statutes and it may be somewhat easier to apply than the weighing and balancing of recent decisions of sister circuits.⁷⁰

ford those who risk their capital at least a fair chance of realizing their objectives in legitimate ventures whether or not they expect a return on their capital in one form or another." *Id.*, 361 P.2d at 908-09, 13 Cal. Rptr. at 188-89.

65. *Great W. Bank*, 532 F.2d at 1257-58.

66. *Golden v. Garafalo*, 678 F.2d 1139 (2d Cir. 1982); *Allegaert v. Chemical Bank*, 657 F.2d 495 (2d Cir. 1980); *Exchange Nat'l Bank of Chicago v. Touche Ross & Co.*, 544 F.2d 1126 (2d Cir. 1976). See also *Aldrich v. New York Stock Exch.*, 446 F. Supp. 348, 356 (S.D.N.Y. 1977); *Commercial Discount Corp. v. Lincoln First Commercial Corp.*, 445 F. Supp. 1263, 1266 (S.D.N.Y. 1978). But see, *Ayala v. Jamaica Sav. Bank*, FED. SEC. L. REP. (CCH) ¶ 98041 (E.D.N.Y. June 1, 1981); *Tanuggi v. Grolier, Inc.*, 471 F. Supp. 1209 (S.D.N.Y. 1979), which decline to follow the literal view.

67. See, e.g., *Sonnenschein*, *supra* note 9, at 1601. This approach was initially referred to as the "strong family resemblance" test. See, e.g., *Lipman, Notes as Securities*, 11 REV. SEC. REG. 853 (1978).

68. *Exchange Nat'l Bank of Chicago v. Touche Ross & Co.*, 544 F.2d 1126, 1137 (2d Cir. 1976). See *supra* note 3 for the text of the definitional sections of the 1933 and 1934 Acts.

69. *Exchange Nat'l Bank*, 544 F.2d at 1137-38 (emphasis in original) (construing 15 U.S.C. § 77(b) (1976); 15 U.S.C. § 78c(a) (1976)).

70. *Exchange Nat'l Bank*, 544 F.2d at 1138.

The "literal view" thus purports to resolve all "gray-area" cases in favor of an affirmative determination of anti-fraud coverage, whereby the court must evaluate the specific instrument against examples which unquestionably do not invoke the federal securities acts.⁷¹ Presumably, where a party cannot prove that "the context otherwise requires" vis-a-vis Judge Friendly's enumerated examples, the anti-fraud coverage is held to apply. It appears that with one exception, courts outside the Second Circuit have not followed this approach.⁷²

With this background, it is not suprising that today the status of the law as to what actually does constitute a security is one of confusion and internal contradiction. Flanked by its own *Howey-Foreman-Daniel* analysis⁷³ on the one side and the various circuit court tests⁷⁴ vying for applicability on the other, the Supreme Court undertook once again to determine whether a specific instrument was a "security" as that word is defined in the federal securities laws.

B. The Weaver Decision

1. Statutory Analysis

The Court analyzed the certificate of deposit and the purchase agreement by initially scrutinizing the statutory framework of the Securities Exchange Act of 1934,⁷⁵ once again recognizing the breadth of the definition of the term "security."⁷⁶ While the Court acknowledged that the literal words of the 1934 statute excluded "only" currency and notes with a maturity of less than nine

71. Sonnenschein, *supra* note 9, at 1603.

72. The United States District Court for the District of Columbia has stated a preference for the literal approach since it is the "most consistent with the language of the statute and Congressional intent and is by far the easiest test to apply." SEC v. Diversified Industries, 465 F. Supp. 104, 110 (D.D.C. 1979).

73. See *supra* notes 35-55 and accompanying text.

74. See *supra* notes 56-72 and accompanying text.

75. While the Court analyzed only the 1934 Act, it recognized the 1933 Act as well by noting the definitional provisions of both acts are "essentially the same." 102 S. Ct. at 1223 n.3. Although there are some technical differences in the definitions contained in the 1933 Act and the 1934 Act, e.g., variation in language of the two acts relating to oil, gas, and mineral interests; omission in 1934 Act of the term "evidence of indebtedness," both the Senate Report and the Supreme Court have, prior to *Weaver*, recognized that the two definitions are functional equivalents. *Techerepnin v. Knight*, 389 U.S. 332, 336, 342 (1967) ("virtually identical"); S. REP. NO. 792, 73d Cong., 2d Sess. 14 (1934) ("substantially the same"). Nevertheless, some commentators have observed that the differences may present several problems of statutory construction. See, e.g., Hannan & Thomas, *supra* note 9, at 221; Sonnenschein *supra* note 9, at 1573.

76. 102 S. Ct. at 1223.

months,"⁷⁷ it nonetheless rejected a literal interpretation of the Act⁷⁸ in favor of a more subjective, policy-oriented analysis. This analysis contained three touchstone reasons for justifying the Court's conclusion that the Weavers' certificate of deposit was not a security within the definitional language of the securities laws.⁷⁹

First, the Court noted that the statutory language included ordinary stocks and bonds, as well as "countless and variable schemes devised by those who seek the use of the money of others on the promise of profits . . . [including] uncommon and irregular instruments."⁸⁰ The Court concluded that in order to encompass such schemes and instruments, the test of a security "is what *character* the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect."⁸¹ It may thus be concluded that this character mandate requires an inquiry into how the instrument is perceived by the business world rather than how it is labeled by its advocates.

Second, the Court recognized a very important exception to the statute's definitional language: the provision is prefaced "by the statement that the terms mentioned are not to be considered securities if 'the context otherwise requires . . . ' "⁸² While not elaborating on this prefatory language, the Court undoubtedly realized that, in addition to a character analysis, the special use of this provision⁸³ warranted a case-by-case investigation into the factual context surrounding the application of the purported security.⁸⁴

77. *Id.* (emphasis added).

78. See *supra* notes 66-72 and accompanying text for one circuit's view of the "literalist approach."

79. See Pitt, *supra* note 9, at 11, col. 2, for an examination of the Court's three-part statutory analysis.

It should be recognized that both acts contain the statutory language "certificate of deposit, for a security." However, the Court acknowledged that the language does not ostensibly apply to modern high-yield certificates of deposit: "Instead, 'certificate of deposit, for a security' refers to instruments issued by protective committees in the course of corporate reorganizations." 102 S. Ct. at 1224, n.5 (quoting *Canadian Imperial Bank of Commerce v. Finland*, 615 F.2d 465, 468 (7th Cir. 1980)).

80. 102 S. Ct. at 1223 (quoting *SEC v. W.J. Howey, Inc.*, 328 U.S. 293, 299 (1946)); *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 10 (1971); *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 351 (1943).

81. *Id.* (emphasis added) (citing *United Benefit Life Ins. Co.*, 387 U.S. at 24; *C.M. Joiner Leasing Corp.*, 320 U.S. at 352-53).

82. 102 S. Ct. at 1223.

83. The provision, "unless the context otherwise requires," is relatively uncommon in federal statutes. Apart from the federal securities laws, there are only 38 statutory sections of the United States Code that contain the phrase "unless the context otherwise requires." See Pitt, *supra* note 9, at 18, col. 4, n.29.

84. It has been suggested by several commentators that the phrase refers to the context of the statute, not the circumstances surrounding the instrument. Hence, the definitions in the statutory language are deemed to govern unless

Finally, the Court was satisfied in not applying the broad statutory language as a blanket provision simply by virtue of the fact that "Congress, in enacting securities laws, did not intend to provide a broad federal remedy for *all* fraud."⁸⁵

Thus, it appears the Court has absolved itself of a strict and literal statutory standard when determining whether the federal security laws are applicable to any specific instrument. Although the Court had recognized the "economic realities" element some fifteen years earlier,⁸⁶ it has still, on occasion, clung to a literalist approach to statutory analysis in even its most recent securities law decisions.⁸⁷ Nevertheless, it appears that any question as to whether the literal view is still applicable must be resolved in the negative in light of the economic realities of the instrument analysis as well as the new, case-by-case character analysis of how an instrument is perceived within the business community.⁸⁸ In ad-

the language surrounding the term elsewhere in the act indicates otherwise. See *Loss*, *supra* note 4, at 2485 (Supp. 1969); *Hannan & Thomas*, *supra* note 9, at 278; Comment, *supra* note 9, at 238-39. See also *SEC v. National Securities, Inc.*, 393 U.S. 453 (1969), where the Supreme Court recognized: "Congress itself has cautioned that the same words may take on a different coloration in different sections of the securities laws; both the 1933 and the 1934 Acts preface their lists of general definitions with the phrase 'unless the context otherwise requires.'" *Id.* at 466 (emphasis added).

85. *Id.* at 1223 (emphasis added). The Court, however, did not refer to any legislative history in asserting such congressional intent. Rather, the Court relied solely on two appellate decisions, *Great W. Bank and Trust v. Kotz*, 532 F.2d 1252, 1253 (9th Cir. 1976) and *Bellah v. First Nat'l Bank of Hereford*, 495 F.2d 1109, 1114 (5th Cir. 1974). In fact, the Court had previously held in *Superintendent of Ins. v. Bankers Life and Casualty Co.*, 404 U.S. 6 (1971), that section 10(b) and rule 10b-5 "prohibit *all* fraudulent schemes in connection with the purchase or sale of securities, whether the artifices employed involve a garden type variety of fraud, or present a unique form of deception Novel or atypical methods should not provide immunity from the security laws." *Id.* at 11 n.7 (emphasis in the original). For a discussion of legislative history, see *supra* note 31.

86. *Tcherepnin v. Knight*, 389 U.S. 332 (1967).

87. See, e.g., *Steadman v. SEC*, 450 U.S. 91, 97 (1981) ("The search for congressional intent begins with the language of the statute."); *Rubin v. United States*, 449 U.S. 424, 429 (1981) ("We begin by looking to the language of the Act.").

88. But see *Golden v. Garafalo*, 678 F.2d 1139 (2d Cir. 1982), which was decided after *Weaver*. *Golden* involved a purchase of 100 percent of the outstanding stock of a corporation, the plaintiffs subsequently alleging misrepresentation of the business' value. The court stated that the economic realities test enunciated in *Weaver* was inapplicable, and that Congress intended to draft an expansive definition and to include all instruments, even those commercial in nature. *Id.* at 1144. See also *Chemical Bank v. Arthur Andersen & Co.*, 552 F. Supp. 439 (S.D.N.Y. 1982) ("The Second Circuit [has since *Weaver*] concluded that an economic reality analysis is inappropriate in most situations and essentially affirmed the literalist approach to determining whether an instrument is a security within the meaning of the securities laws.").

dition, it appears that the Court is content to hold that not all fraud is covered by the securities laws simply by recognizing that the acts' definitional provision is qualified by the prefatory expression "unless the context otherwise requires."

2. *The Certificate of Deposit*

After fashioning this redefined statutory analysis⁸⁹ to the securities laws in the first part of its opinion, the Court was left to apply the analysis to the certificate of deposit and the business agreement. In respect to the certificate of deposit, the Court concluded that it should not be treated as a security for two essential reasons. First, the note differed significantly from other long-term debt obligations in that it "was issued by a federally regulated bank which is subject to the comprehensive set of regulations governing the banking industry."⁹⁰ Second, the purchaser of a bank certificate of deposit "is virtually guaranteed payment in full, whereas the holder of an ordinary long-term debt obligation assumes the risk of the borrower's insolvency."⁹¹

The Court's first reason for not finding the certificate of deposit to fall within the parameters of the securities definitions was based primarily on the passage of the Glass-Steagall Act,⁹² established concurrently with the 1933 and 1934 Acts to regulate the banking industry and protect depositors.⁹³ Under this federal bank regulatory scheme, almost all phases of the business of national, state member, and insured state nonmember banks are regulated at the federal level.⁹⁴ As one commentator has observed:

The regulation of banking may be more intensive than the regulation of any other industry, and it is the oldest system of economic regulation. This system may be one of the most successful, if not the most successful. The regulation extends to all major steps in the establishment and development of a national bank, including not only entry into the business, changes in status, consolidations, and reorganizations, but also the most

89. See *supra* notes 80-85 and accompanying text.

90. 102 S. Ct. at 1224.

91. *Id.* at 1224-25.

92. Banking (Glass-Steagall) Act of 1933, ch. 89, 48 Stat. 162 (1933) (codified at 12 U.S.C. § 227 (1976 & Supp. IV 1980)).

93. The Act was designed to closely supervise the financial activity and stability of banks, see *infra* note 94, as well as create the Federal Deposit Insurance Corporation (FDIC), see *infra* note 104. See generally 77 CONG. REC. 3725-31 (1933).

94. Such regulation includes the following:

Entry into the banking industry, 12 U.S.C. §§ 27, 322, 1814 (1976 & Supp. V 1981); reserve requirements, 12 U.S.C. § 461(b) (1976 & Supp. V 1981); reporting requirements, 12 U.S.C. §§ 151, 324, 1817 (1976 & Supp. V 1981); inspection requirements, 12 U.S.C. §§ 481, 483, 1820(b) (1976 & Supp. V 1981); limits on advertising interest paid on deposits, 12 C.F.R. §§ 217.6, 239.8 (1982). See also 102 S. Ct. at 1224 n.8.

intensive supervision of operations through regular examination of banks.⁹⁵

The Court was undoubtedly influenced greatly by this comprehensive regulation. However, an examination of these statutes reveals some question as to whether there are any *individual* rights or remedies available.⁹⁶ It appears the sole purpose of the banking regulations is to ensure the financial stability of banks as well as to ensure full and fair disclosure in the financial markets. The only right to an individual remedy that seems possible is that right which permits the bank regulatory agencies to rectify any violation of "law, rule, or regulation"⁹⁷ through a cease and desist order, that may require the bank to "take affirmative action to correct the conditions resulting from any such violation or practice."⁹⁸ Whether such "affirmative action" encompasses a benefit to a defrauded individual has yet to be addressed by the courts.⁹⁹

The Court's reliance on the existence of an independent statutory scheme was initially recognized in the *Daniel* decision,¹⁰⁰ where the Court held that the existence of ERISA preempted application of the securities acts.¹⁰¹ However, in *Daniel*, the Court's reliance upon ERISA was only of secondary importance in reaching its result, because the *Daniel* decision discussed the lack of the need for application of the federal securities laws only *after* applying the *Howey* formulation to the facts of the case.¹⁰² In contrast, the Court in *Weaver* treated the existence of the banking regulatory scheme as a *prime* reason for denying federal securities law coverage to certificates of deposit issued by federally insured banks without any application of the tests announced in *Howey* and its progenies.¹⁰³

The Court's second and interrelated rationale for not applying

95. K. DAVIS, ADMINISTRATIVE LAW TREATISE § 4.04, at 247 (1958) *quoted in* brief for the United States as amicus curiae at 11.

96. For example, under 12 U.S.C. § 1818 (1976 & Supp. V 1981), a cease and desist order may be issued if "unsafe or unsound" practices by a bank are detected. *Id.* at § 1818(b)(1). Also, officers may be removed for breaches of fiduciary duty to the bank where the bank has or probably will suffer "substantial financial loss," or the interests of depositors generally are "seriously prejudiced." *Id.* at § 1818(e).

97. 12 U.S.C. § 1818(b)(1) (1976 & Supp. V 1981).

98. *Id.*

99. *Accord*, Brief for Myrna Ayala as amicus curiae in support of the respondents at 15.

100. 439 U.S. 551 (1979). *See supra* notes 49-55 and accompanying text.

101. *See supra* notes 49-54 and accompanying text.

102. 439 U.S. at 569-70.

103. 102 S. Ct. at 1224 & n. 7. *See also* Arnold, *supra* note 9, at 2203; Pitt, *supra* note 9, at 11, col. 4. The article by Pitt contends that the ERISA formulation was of secondary importance because the pension plan at issue in *Daniel* was not subject to ERISA.

the securities laws to the certificate of deposit was the federal guaranty underlying the note; specifically, the federal deposit insurance fund administered by the Federal Deposit Insurance Corporation (FDIC).¹⁰⁴ The Court focused on the "virtually guaranteed payment" by the FDIC should the bank become insolvent¹⁰⁵ and concluded that the certificate of deposit at issue should not be treated as a security because it was not subject to the risk of the borrower's insolvency as would be the case of an ordinary long-term debt obligation.¹⁰⁶ Here again, the problem is that the federal insurance program provides a guarantee for the depositor only if the bank should go insolvent, and does not address the issue pertaining to potential deceptive acts perpetrated by a banking institution.

One explanation which the Court quickly rebuffed was that the *Weaver* certificate of deposit was the functional equivalent of the withdrawable capital shares of a savings and loan association held to be securities in *Tcherepnin v. Knight*.¹⁰⁷ The Court flatly rejected this conclusion. It held that the withdrawable capital shares found in *Tcherepnin* did not pay a fixed rate of return as in the *Weavers'* case, but instead paid dividends based on the association's profits. In addition, the purchasers in *Tcherepnin* received voting rights. The Court concluded that an instrument containing these two elements found in *Tcherepnin* more closely evidenced the "ordinary concept of a security." Consequently, *Tcherepnin* was not controlling in a situation such as the *Weavers'* where the instrument did not contain either of these features.¹⁰⁸

3. *The Profit Sharing Agreement*

Having concluded that a certificate of deposit issued by a federally regulated bank was not a security for purposes of the securi-

104. 102 S. Ct. at 1224. The FDIC's creation and regulatory duties are codified at 12 U.S.C. § 1811-1832 (1976 & Supp. V 1981). To qualify for federal deposit insurance, a bank must satisfy FDIC standards with respect to the use of the bank's capital structure, financial history, potential for future earnings, and management. 12 U.S.C. § 1816 (1976). See also *supra* note 94.

105. 102 S. Ct. at 1224. (citing 1980 ANNUAL REPORT OF THE FDIC 18-21 (1981)) ("With respect to the 568 federally insured banks that were closed as of year-end 1980, 99.9% of the depositors actually received or were assured payment of their deposits in full . . .").

106. *Id.* at 1225.

107. 389 U.S. 332 (1967). *Tcherepnin* involved withdrawable capital shares in an Illinois savings and loan association where state law attached the payment of dividends on the withdrawable shares to an apportionment of profits. Investors' monies thus represented all of the association's capital, and the certificate holders could expect a return on their investment only if the savings and loan association made a profit. *Id.* at 338-39.

108. 102 S. Ct. at 1224.

ties laws, it was necessary for the Court to determine whether the Weavers' claim that their profit sharing agreement with the slaughterhouse owners constituted a separate security subject to the anti-fraud provisions of the acts. It was here that the Court first addressed the *Howey* test,¹⁰⁹ citing the lower court's observation that the agreement fell within the definition of an "investment contract" to which the *Howey* test originally applied.¹¹⁰ Acknowledging the *Howey* test, the Court concluded that the agreement was not a security because it was "not the type of instrument that comes to mind when the term security is used"¹¹¹ The Court reasoned:

The unusual instruments found to constitute securities in prior cases involved offers to a number of potential investors, not a private transaction as in this case. In *Howey*, for example, 42 persons purchased interests in a citrus grove during a four-month period. . . . In *C.M. Joiner Leasing*, offers to sell oil leases were sent to over 1,000 prospects. . . . In *C.M. Joiner Leasing*, we noted that a security is an instrument in which there is "common trading. . . ." The instruments involved in *C.M. Joiner Leasing* and *Howey* had equivalent values to most persons and could have been traded publicly. . . . Accordingly, we hold that this unique agreement . . . is not a security.¹¹²

Thus, it now appears that an instrument or agreement is "not the type of instrument that comes to mind when the term security is used" if it does not contain, in addition to the *Howey-Foreman-Daniel* elements, a showing that: (1) offers were made to a number of potential investors, and not offered as part of a private transaction; (2) the instruments have equivalent values to most persons; (3) the instrument in question has the ability to be traded publicly; and (4) the particular instrument contains no significant features unique to the party alleging the fraud.¹¹³

While each of the four refinements have their own peculiar attributes, collectively they appear to be an extension of the "common enterprise" prong¹¹⁴ of the *Howey* test. This common enterprise element has recently been addressed by a number of courts, with two schools of thought emerging from such an examination. One school of thought emphasizes commonality among investors and requires "a sharing or pooling of funds" by multiple investors.¹¹⁵ This view has been labeled the horizontal ap-

109. See *supra* notes 35-40 and accompanying text.

110. 102 S. Ct. at 1225.

111. *Id.*

112. *Id.* (citations omitted).

113. See also Arnold, *supra* note 9, at 2203; Pitt, *supra* note 9, at 18, col. 1.

114. See *supra* text accompanying note 38.

115. *Hirk v. Agri-Research Council, Inc.*, 561 F.2d 96, 99-102 (7th Cir. 1977). See also *Milnarik v. M-S Commodities, Inc.*, 457 F.2d 274 (7th Cir.), *cert. denied*, 409 U.S. 887 (1972).

proach.¹¹⁶ The other, identified as the vertical approach, emphasizes the commonality between the promoter and the investor and only requires a "one-to-one relationship between an investor and an investment manager."¹¹⁷ After the *Weaver* decision, it appears the Supreme Court has inferably adopted the horizontal approach,¹¹⁸ because such an approach necessarily requires more than one investor.¹¹⁹ In any event, the argument advanced by some courts that a vertical approach may include a single investor appears to be unequivocally rejected.¹²⁰ Likewise, when an instrument confers on its holder rights that are not readily comparable to the rights conferred by any other instrument of the issuer, it cannot conveniently travel in the public financial markets, and those markets cannot perform their pricing function in such a case.¹²¹ Under the *Weaver* rationale, such an instrument cannot now be afforded the protections of the securities anti-fraud legislation. Finally, the Court recognizes that an instrument, even if it is financial, is not a security if it is not "eligible" to be bought and sold in the public market.¹²² In the final analysis, it appears that after *Weaver*, a "unique, [privately transacted] agreement, negotiated one-on-one by the parties,"¹²³ will no longer be afforded the protection of the securities laws' anti-fraud provisions.

4. *The Court's Caveat*

After involving itself in a detailed analysis of both the certificate of deposit and business agreement, the Court concluded that "[w]hatever may be the consequences of these transactions, they did not occur in connection with the purchase or sale of 'securi-

116. See, e.g., 8 FLA. ST. L. REV. 129 (1980).

117. *Troyer v. Karcagi*, 476 F. Supp. 1142, 1147-48 (S.D.N.Y. 1979).

118. Offers must be made to "a number of potential investors . . ." 102 S. Ct. at 1225 (emphasis added).

119. However, the Fifth Circuit has opted for the vertical approach, even where a large number of investors are involved. See *SEC v. Continental Commodities Corp.*, 497 F.2d 516 (5th Cir. 1974); *SEC v. Koscot Interplanetary, Inc.*, 497 F.2d 473 (5th Cir. 1974).

120. See, e.g., *Troyer v. Karcagi*, 476 F. Supp. 1142, 1147 (S.D.N.Y. 1979) (link between any single investor and promoter is "sufficient"); *Huberman v. Denny's Restaurants, Inc.*, 337 F. Supp. 1249, 1251 (S.D. Colo. 1972) ("immaterial that only a single investor involved").

121. For a comprehensive analysis pertaining to the uniqueness of an instrument, see FitzGibbon, *supra* note 9, at 929.

122. 102 S. Ct. at 1225. See also FitzGibbon, *supra* note 9, at 926. This public offering theory would seem to contradict *SEC v. Ralston Purina Co.*, 346 U.S. 119 (1953), where the Court held that the sale of unissued common stock by a corporation to "key" employees, and not the general public, nevertheless had to comply with the registration requirements of the Act.

123. 102 S. Ct. at 1225.

ties.'"¹²⁴ However, apparently to avoid "judicial codification"¹²⁵ of its decision regarding all certificates of deposit and profit sharing agreements, the Court presented a caveat by way of a footnote:

It does not follow that a certificate of deposit or business agreement between transacting parties invariably falls outside the definition of a security as defined by the federal statutes. Each transaction must be analyzed and evaluated on the basis of the content of the instruments in question, the purposes intended to be served, and the factual setting as a whole.¹²⁶

In doing so, the Court was undoubtedly persuaded by the argument, advanced by the SEC acting as *amicus curiae*, that in other contexts, such as certificates of deposit issued by nonregulated banks and money market funds covered under the Investment Company Act, a different result may be appropriate.¹²⁷ Such an evaluation is in accord with the Court's statutory character analysis as set forth in the first part of its decision.¹²⁸ Nonetheless, as has been suggested by one writer, the imposition of such a burden may procure more, rather than less, litigation in the future.¹²⁹ Irrespective of whether the lower courts take heed to such case-by-case factual evaluations, it appears that further elaboration from the Court will be necessary before this issue is settled.

IV. CONCLUSION

The Supreme Court's decision in *Weaver* was correct in determining that a certificate of deposit was not a security for purposes of the securities laws and regulations, and indeed, was predictable in light of previous judicial decisions¹³⁰ as well as other more re-

124. *Id.*

125. For example, the Court recently declined to adopt either of two tests embraced by several circuit courts construing previous Supreme Court decisions concerning the scope of the attorney-client privilege: "We are acutely aware, however, that we sit to decide concrete cases and not abstract propositions of law. We decline to lay down a broad rule or series of rules to govern all conceivable future questions in this area, even were we able to do so." *Upjohn Co. v. United States*, 101 S. Ct. 677, 681 (1981).

126. 102 S. Ct. at 1225 n.11.

127. Brief for the United States as *amicus curiae* at 20.

128. See *supra* notes 75-88 and accompanying text.

129. Pitt, *supra* note 9, at 18, col. 2.

130. The lower courts generally have held that certificates of deposit issued by federally regulated banks are not securities. *Meason v. Bank of Miami*, 652 F.2d 542 (5th Cir. 1981), *cert. denied*, 455 U.S. 939 (1982); *Bellah v. First National Bank of Hereford*, 495 F.2d 1109 (5th Cir. 1974); *Ayala v. Jamaica Sav. Bank*, FED. SEC. L. REP. (CCH) ¶ 98041 (E.D.N.Y. June 1, 1981); *Hendrickson v. Buchbinder*, 465 F. Supp. 1250 (S.D. Fla. 1979); *Hamblett v. Board of Savings and Loan Ass'ns*, 472 F. Supp. 158 (N.D. Miss. 1979); *SEC v. Fifth Avenue Coach Lines, Inc.*, 289 F. Supp. 3 (S.D.N.Y. 1968). See generally *Burrus, Cootes and Burrus v. MacKethan*, 537 F.2d 1262 (4th Cir. 1976), *opinion withdrawn and prior judgment aff'd on other grounds*, 545 F.2d 1388 (4th Cir. 1976), *cert. denied*, 434 U.S. 826 (1977).

cent trends.¹³¹ This observation is buttressed by the fact that while the SEC had long taken the position that bank certificates of deposit were securities,¹³² it abruptly abandoned that position after the Supreme Court granted certiorari in *Weaver*.¹³³ While the *Weaver* conclusion is consistent with the recent trend, the decision nevertheless departs from some of the Supreme Court's most prominent and fundamental earlier securities rules in order to reach that conclusion. One important departure seems to be the Court's relegation of the *Howey* test to a secondary position when other federal remedies and safeguards are available. However, this type of analysis could conceivably take other instruments, historically considered to be securities, outside the setting of securities law regulation.¹³⁴

The second departure that may have even greater ramifications deals with those instruments which are unique, privately negotiated, or unavailable to be traded publicly. The question arises as to whether an instrument is any less a security because it contains one of the above elements, even where it otherwise meets all the *Howey-Foreman-Daniel* conditions. It appears that while the anti-fraud provisions of the federal securities laws may still be applicable to "novel, uncommon, or irregular devices," as originally set out by the Court in 1943,¹³⁵ it is now questionable whether such protection will be afforded to an instrument which contains "unique" features, or is not publicly traded or offered to a number of potential investors.

131. For example, the American Law Institute has proposed in its Federal Securities Code a comprehensive definition of "security," including a list of exclusions: "Notwithstanding section 299.53(a), 'security' does not include . . . a bank certificate of deposit that ranks on a parity with an interest in a deposit account with the bank" FED. SECURITIES CODE § 299.53(b)(5) (Proposed Official Draft 1980).

132. For example, the SEC filed an amicus curiae brief in *Safeway Portland Employees Fed. Credit Union v. Wagner & Co.*, 501 F.2d 1120 (9th Cir. 1974), arguing that "a CD is an exempt security under the Act." *Id.* at 1124.

133. Brief for the United States [including the SEC, among other agencies] as amicus curiae at 6-26, *Marine Bank v. Weaver*, 102 S. Ct. 1220 (1982).

134. An example would be brokerage firm discretionary accounts, which are already heavily regulated by either the SEC, the Commodity Futures Trading Commission, or individual state blue-sky laws. In addition, brokerage firms are under the jurisdiction of the Securities Investor Protection Corp. (SIPC) in the event of insolvency, a function similar to that assigned to the FDIC. Under the *Weaver* rationale, it would appear unnecessary to subject such discretionary accounts to liability under the anti-fraud provisions of the federal securities laws since such accounts are already amply protected. See generally H. BLOOMENTHAL, 1981 SECURITIES LAW HANDBOOK 244-48 (1981); LOSS, *supra* note 4, at 1479-81; Moreno, *Discretionary Accounts*, 32 U. MIAMI L. REV. 401 (1978); Pitt, *supra* note 9, at 11, col. 4.

135. *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 351 (1943).

Such divergences from the Court's previous securities principles could conceivably create new ambiguities for lower courts to deal with when determining whether to apply the federal securities acts to the specific instruments with which they are presented. Moreover, *Weaver* failed to resolve any major potential issues that have beleaguered the courts since the decision in *Howey*.¹³⁶ While it appears that the Court has rejected the Second Circuit's literalist approach¹³⁷ in favor of a more ad hoc analysis into the character of the instrument, much remains to be said as to whether the commercial-investment dichotomy, risk-capital approach, or either, constitute a viable and accurate test for determining whether a certain instrument is a security. It would seem that while the Court's intent was to limit application of the securities laws to those types of instruments for which the acts were created fifty years ago, its decision may in fact allow deceptive parties to structure an instrument to fall outside the securities laws, when in fact the securities anti-fraud provisions would be the best method to deal with such fraudulent schemes.¹³⁸ Such a result would undoubtedly accomplish little in the way of curtailing superfluous securities litigation, and indeed, may actually initiate more litigation than would otherwise be necessary to resolve these newly created ambiguities.

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136. See, e.g., *supra* notes 40 & 114-123 and accompanying text.

137. But see *supra* note 88.

138. An example would be notes issued by a highly speculative investment company utilizing lax banking regulations in a foreign jurisdiction in order to label itself a "bank." Such a scheme could arguably come within the purview of the International Banking Act, 12 U.S.C. §§ 611-32 (1976 & Supp. V 1981), and thus would not be subject to the anti-fraud provisions of the federal securities laws. See generally Korstein, *The CD Muddle*, 9 SEC. REG. L.J. 395 (1982).